



Nos. 387-388

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

RECONSTRUCTION FINANCE CORPORATION,
Petitioner,

v.

BANKERS TRUST COMPANY, Trustee,
Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

**AMICUS CURIAE BRIEF OF IRVING TRUST
COMPANY**

✓ H. C. McCOLLUM,
One Wall Street,
New York, N. Y.,
*Attorney for Irving Trust Company,
Amicus Curiae.*

Dated, December 26, 1942.

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AMICUS CURIAE BRIEF OF IRVING TRUST COMPANY

Irving Trust Company is the trustee under various railroad mortgages; and its position in pending reorganizations under Section 77 of the Bankruptcy Act will be strongly affected by the decision of this Court.

It is a party to the *New York, New Haven & Hartford Railroad Company reorganization* case—in which was rendered the decision of Judge Hincks in the United States District Court for the District of Connecticut, a copy of which decision is annexed as Appendix B to the petitioner's brief herein. This decision—which is important in the consideration of the present case—related to two

parallel compensation petitions, one of which was filed by Bankers Trust Company as Trustee, and the other of which was filed by Irving Trust Company as Trustee.

In common with other indenture trustees, it has been affected adversely and unfairly (as it believes) by the fact that, although its duties have required it to participate actively in extended railroad reorganizations and to use its best efforts to protect its bondholders, its compensation (including that of its counsel) has been consistently minimized, after the completion of such services, by the holdings of the Interstate Commerce Commission and of lower courts to the effect that, regardless of the extent of the services performed *for its bondholders*, compensation cannot be allowed beyond the amount of the benefit contributed by such services *to the estate of the debtor* or, as otherwise stated, benefit to the reorganization.

POINT I

Indenture trustees are not mere volunteers in Section 77 proceedings. They are charged, after default, with active duties to protect their bondholders; and their services are performed primarily for their bondholders, not for the benefit of the debtor's estate.

Preceding the compensation report of the Commission (247 I.C.C. 677) in the *New York, New Haven & Hartford Railroad Company* case—which report is discussed in the above-mentioned decision of Judge Hincks—three indenture trustees had requested the Commission to clarify the basis upon which it fixes compensation to indenture trustees in Section 77 cases. In response to this request, the Commission, in its said compensation report, stated

in substance (247 I.C.C., at 696) that it regards indenture trustees as mere volunteers in a Section 77 proceeding; also that it does not fix compensation of indenture trustees "on the basis of the indenture contracts"; and that such volunteer services, not being required by the indentures, are not to be paid for as if so required. These statements are very illuminating because they demonstrate that the Commission, in fixing maximum limits, has acted upon a misconception of the duties of such trustees. In said decision of Judge Hincks, he disagreed with this fundamental theory of the Commission and correctly stated that an indenture trustee, far from being a mere volunteer in Section 77 cases, is charged with the active duty of protecting the bondholders. Until the decisions of the courts below in the present case, the situation has been that indenture trustees—believing it to be their duty to attempt to obtain proper relative treatment for, and otherwise to protect, their bondholders in Section 77 cases and having actively participated therein (often where there was no other representative of their bondholders)—have been told by the Commission and by the courts that they cannot recover for their services, except to the limited extent that they may have benefited the debtor's estate.

A similar misconception of trustees' obligations is shown by the brief of Reconstruction Finance Corporation herein, wherein it states (at p. 28), in effect, that if an indenture trustee does not wish to have its compensation limited by the Commission's standards, the trustee has "an unfettered option to resign its trust". This may be true, legally speaking; but it is certainly not the understanding which indenture trustees have of their obligations. They have accepted numerous trusts under which they undertook the duty to use their best efforts to protect

their bondholders after default. Conscientious trustees do not believe that, having accepted such trusts, they have an "unfettered" option to resign, when their services are most needed, if not assured of the reasonable compensation provided for in their indentures.

By the same contracts under which trustees accept their duties it is provided that they shall receive reasonable compensation. While the language of the indenture provisions varies somewhat, the indenture to Bankers Trust Company, as Trustee, in the present case is quite typical in stating that such compensation is to be paid for "all services rendered . . . in the execution of the trusts hereby created". Such compensation, as is stated in the brief of Bankers Trust Company, is secured by a prior lien upon the trust estate—whether by the specific provisions of the indenture or by well-settled law. While the obligations of the trustees continue and are increased by Section 77 proceedings, it is proposed by the petitioner and those supporting its position herein that the coordinate portion of the contract providing reasonable compensation for the performance of such obligations be ignored.

POINT II

The courts have power to fix allowances payable out of the mortgaged assets, to mortgage trustees under their indenture contracts, independent of the limitations contained in Section 77(c)(12) of the Bankruptcy Act. The Congress did not intend otherwise.

We desire not to duplicate the arguments contained in the respondent's brief. As later stated, in Point III, one purpose of the present brief is to supplement the respondent's brief and to request that this Court's decision shall cover the important general question raised by said Point III. Also, we wish to state, in a somewhat different way, a portion of the argument contained in the respondent's brief.

Section 77(c)(12) might have been interpreted in either of two ways: *first*, as meaning that in fixing allowances under that section the Interstate Commerce Commission should adopt the same standard* of "reasonable compensation" as has been applied by the courts for many years; or, *second*, as meaning that a new and different standard of "reasonable compensation" was created by that section.

If the first of such interpretations had been adopted, the position of petitioner herein would be substantially stronger, in our opinion, than it is. It is probably true that, even under such an interpretation, the exclusion of the courts from passing upon compensation, except within the maximum limits fixed by the Commission, is constitutionally objectionable; but this subject is fully dealt with by respondent's brief. We assume (passing by the constitutional questions) that there is force in an argu-

* By the word "standard," as used in this brief, we mean the elements to be considered in arriving at compensation.

ment that, if the standard of "reasonable compensation" were the same, the rights of trustees would not be violated if the Commission, rather than the courts, were to apply such standard in Section 77 cases. However, as interpreted by the courts and by the Commission, Section 77 created an entirely different standard of "reasonable compensation". The standard thus created was much narrower than the usual standard of such compensation under a mortgage, in that (a) the standard of such compensation under a mortgage is based upon the services rendered for the bondholders and the other elements stated in *In re Osofsky*, 50 Fed. (2d) 925 (D. C. S. D. N. Y.), while (b) the primary standard to be followed, and which has been followed, by the Commission in Section 77 cases is benefit to the estate of the debtor or, as otherwise stated, to the reorganization. The standard followed by the Commission accords with numerous decisions of the courts in cases construing the identical provisions of former Section 77B and also with the decisions in *Abrams v. Scandrett*, 121 Fed. (2d) 371 (C.C.A. 7) and *Hugg v. Crooks*, 122 Fed. (2d) 366 (C.C.A. 8) construing the provisions of Section 77(e)(12) (although the decisions did not specifically relate to indenture trustees).

The distinction made in the Section 77B cases, as between benefit to the estate of the debtor on the one hand and services for a particular creditor on the other hand, is emphasized by those cases which hold that an allowance of compensation out of the debtor's estate, based on benefit to the estate, does not prevent recovery of the balance of the reasonable value of compensation from the parties for whom the applicant was acting:

In re Davison Chemical Co., 14 F. Supp. 820, 833 (S.D.N.Y.);

Silver v. Scullin Steel Co., 98 F. (2d) 503, 508
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Straus v. Baker Co., 87 F. (2d) 401 (C.C.A. 5th);

In re Prudence Bonds Corporation, 122 F. (2d)
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In re Buildings Development Co., 98 F. (2d) 841,
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Teasdale v. Sefton Nat. Fibre Can Co., 85 F. (2d)
379, 382 (C.C.A. 8th);

In re Paramount-Public Corp., 12 F. Supp. 823,
828 (S.D.N.Y.).

In fact, as is mentioned above, the Commission, in the *New York, New Haven & Hartford* case, has specifically stated that in fixing compensation under Section 77(c)(12), it does not base such compensation upon the indenture contracts.

In his above-mentioned decision in the *New York, New Haven & Hartford* case, Judge Hineks was clearly in error—unless the many contrary decisions are erroneous—in stating (p. 62 of R.F.C. brief) that “reasonable compensation” under indenture contracts is to be based upon the same standard as “reasonable compensation” under Section 77. This is true also of the argument contained in the *amicus curiae* brief herein in behalf of the reorganization trustees of the *New York, New Haven & Hartford*, wherein it is stated (at p. 4) that “reasonable compensation” is intended to be the same in both cases. Such an argument is based upon the fact that the same words are used in both cases, and ignores the many court and Commission decisions interpreting such words as found in Section 77(c)(12) in a manner which is entirely different from the interpretation given by the courts in cases other

than Section 77 (and Section 77B) cases. The last-mentioned brief suggests that the fault lies, not in the statutory standard but in the application of that standard by the Commission. A change at this late date in the Commission's standard—even if such a change were justified—could not correct the injustice which has been done in the many cases already acted upon by the Commission.

Furthermore, we believe that such a change would not be justified. We think that the Commission has been compelled to follow the narrower standard, in view of the fact that the courts have not indicated that compensation allowed by the Commission, under Section 77, to indenture trustees (for other than ordinary routine services) is to be based upon a broader basis than benefit to the debtor's estate. Also, we believe that there is a logical reason for basing "reasonable compensation" allowed by the Commission by virtue of Section 77 (as distinguished from "reasonable compensation" under the indenture contracts) upon benefit to the debtor's estate—because that section provides for compensation not only out of the mortgaged assets, but also out of the unincumbered assets of the debtor. For example, the trustee under a debenture agreement, for which there is no pledged security, may be allowed compensation out of the estate. Such a trustee, or a trustee under a mortgage covering property of no value, would have no remedy except to make application under Section 77 for payment out of general assets—in which case, of course, benefit to the estate would have to be shown (and the Commissioner's maximum limits would be exclusive). In other words, the power to allow compensation upon the broader standard applicable to indenture contracts rests in the courts and not in the Com-

mission; and the court below correctly so held in the present case.

The result of the argument, if sustained, which is made by Reconstruction Finance Corporation and such *amici curiae* as support its position would be that in various cases a trustee under a mortgage covering ample assets, and which had rendered services entirely for the benefit of the bondholders and not at all for the benefit of the debtor's estate, would be completely deprived of compensation, although it accepted the trust and performed its duties to the best of its abilities under an indenture contract specifically providing for reasonable compensation for its services; and in spite of the fact that Section 77(f) requires that all liens (including those of the trustees) be satisfied upon consummation of a reorganization plan dealing with the bonds secured by such mortgages.

It certainly cannot be said that the awarding of compensation under the narrowly limited standard adopted under Section 77 takes the place of compensation upon the different and broader basis to which the trustee is entitled under its indenture contract. Therefore, there should not be imputed to the Congress the intention to preclude trustees from proper compensation under their contracts for all of their services in the execution of their trusts. Unless such intention is to be imputed, it must have been intended by Section 77 that the courts retain their power to do equity in such cases.

POINT III

The courts have power to charge reasonable compensation under the indenture contract against the new reorganization securities (or cash) receivable by the bondholders; and, such being the case, there is no good reason why trustees should not be compensated out of mortgaged assets constituting the security for the bondholders. This Court should hold that Section 77 was not intended to prevent trustees from receiving such reasonable compensation out of the mortgaged property; but, if this Court shall not so hold, it should hold that such compensation should be paid out of such new securities (or cash) to the extent that the lower courts shall determine.

In our opinion, there can be no possible answer to the argument that the restrictions imposed by Section 77 apply only to compensation payable "out of the debtor's estate" (Section 77(c)(12)) or "by the debtor, or by any corporation or corporations acquiring the debtor's assets" (Section 77(e)); and that compensation out of the new reorganization securities (or cash) going to the bondholders is not thus payable and therefore is not subject to the restrictions in question. There is no provision in Section 77 restricting compensation except when payable from the sources just mentioned.

The argument of petitioner is that the Congress took away any rights under indentures against the mortgaged security in excess of maximum limits restricted by the benefit to the general estate—although the services were rendered primarily for the protection of the bondholders. Even if (which, of course, we dispute) such arguments

were sound and it could be said that the Congress intended to pass so unreasonable a statute, and that such a statute is constitutional, these arguments cannot possibly affect the right of indenture trustees to the continuance of their lien against the proceeds of the mortgaged or pledged property, distributable to their bondholders. Payment therefrom does not differ in principle from payment by a client. The Section 77B cases above cited clearly hold that, so far as the full compensation claimed is not allowed out of the estate of the debtor, the remedy is against the client.

The only restrictions upon the sources from which compensation can be paid in Section 77 cases are those above mentioned. On the other hand, the equity powers of the court are preserved by the provision in Section 77(a) that, upon the entry of an order approving the reorganization petition

"the court in which such order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose."

Except to the extent that powers are specifically conferred by Section 77 upon the Commission, the equity jurisdiction of the court continues and is exclusive.

Matter of Chicago and Northwestern Ry Co., 121
Fed. (2d) 791 (C.C.A. 7), at 800.

A court of equity certainly has the power and the duty to enforce the trustee's lien against the proceeds of the mortgaged property.

An interesting and illustrative decision in this connection is *Rensselaer & Saratoga R. R. Co. v. Miller & Knapp*, 47 Vt. 146. The court held that, if the mortgage redemption moneys in question had been paid to the trustees instead of to the bondholders, they would have been entitled to the satisfaction therefrom of their proper compensation and expenses; and that the trustees could not be required, as prayed by the plaintiff, to satisfy their lien or part with their interest in the property until paid.

To the same effect, see *Miami Valley G. & F. Co. v. Mills*, 157 App. Div. (1st Dept.) 542.

We emphasize that Section 77(f) requires, as a part of the reorganization, the satisfaction of trustees' and other liens affected by the reorganization plan.

The *Rensselaer* case is quoted at length in *McLane v. P. & S. V. R. R. Co.*, 66 Cal. 606, 622; and the *Rensselaer* and *McLane* cases are the basis of the text in Jones on Bonds and Bond Securities (4th ed.), Section 1090. Various other decisions are the basis of the text in Perry on Trusts and Trustees (7th ed.), from which we quote the following:

“§907. The general rule is that the expenses of a trustee in the execution of the trust are a lien upon the estate, and he will not be compelled to part with the property until his disbursements are repaid.”

In Restatement of Trusts, Section 242, paragraph (3) of Comment, it is stated:

“The trustee . . . need not pay over principal without deducting the compensation to which he is

entitled with respect to the principal. To this extent the trustee has a security interest in the trust property for his compensation."

See also McClelland & Fisher on Corporate Mortgage Bond Issues, at 221.

With reference, generally, to the policy underlying the protection of trustees, see *Bissell v. Butterworth*, 97 Conn. 605.

In *Mersick v. Hartford & W. H. H. R. Co.*, 76 Conn. 11, the court reversed a judgment which distributed to the bondholders the proceeds of a sale of the mortgaged property without making provision for the claim of the trustee.

See also:

Chase National Bank v. Mobile & O. R. Co., 37 F. Supp. 453 (D. C. Ala.).

Smith's ex'x v. Washington City, V. M. & G. S. R. Co., 74 Va. 617.

Section 77 is a substitute for the method of realizing, after default, upon the mortgaged property through the foreclosure of the mortgage. Similarly, if a mortgage were past due, the redemption moneys would stand in place of the property. New securities (or cash) received by bondholders in a Section 77 proceeding are the equivalent of the foreclosure proceeds or redemption moneys payable to them, subject to the trustee's lien. In case of a redemption by payment in full, or in case of a foreclosure, the mortgage is satisfied by a satisfaction piece in the case of such a redemption or, in the case of a foreclosure, by the foreclosure decree, plus the decree confirming the sale, plus the special master's deed joined in by the mortgage

trustee and other parties. These methods are the equivalent of the provisions in Section 77 for the satisfaction of indentures and the conveyance of the mortgaged property.

Even assuming, therefore, that the Congress intended to pass an utterly unreasonable statute as above supposed, there can be no possible argument that the Congress intended that the bondholders should be relieved from payment to their trustee, from the proceeds of their security, for the services rendered on their behalf. As is stated above, the appropriate recourse of trustees is against the security or its proceeds.

See also *Fidelity Trust Co. v. Hutchinson Chemical & A. Co.*, 221 Fed. 63 (C.C.A. 8).

In the last-mentioned case the court held that, where the trustee performed its indenture duties—which consisted of the foreclosure of the mortgage in question—the trustee was entitled to reasonable compensation out of the entire proceeds of sale, including even the proceeds distributable to bondholders who objected to the trustee's action in foreclosing.

A reorganization plan results in a complete separation as between the debtor's estate on the one hand and the new securities (or cash) receivable by the bondholders on the other hand. An argument that the new securities (or cash) form a part of the debtor's estate would lack even plausibility. Payment out of the new securities (or cash) would not diminish in any way the assets of the debtor's estate or of the reorganized company; nor would it increase to any extent the obligations of the reorganized company inasmuch as such company would be totally unaffected by whether the bondholders retained all of their new securities (or cash) or paid some part thereof to their trustees.

Assuming, therefore, that a court below should determine that, upon the usual standard of compensation for services to bondholders, a trustee is entitled to compensation in excess of an amount limited by benefit to the debtor's estate, there is no good reason why the trustee, holding mortgaged assets which belong pro rata to the bondholders subject to the trustee's lien, should not be allowed to receive such compensation out of such assets rather than out of the new securities—unless this Court should be of the opinion that Section 77 prevents payment from the one source but not from the other, even though the effect is the same. In considering whether the Congress intended to prevent indenture trustees from obtaining "reasonable compensation", based upon the usual standards, out of mortgaged assets, we suggest that such a construction would be unreasonable in view of the various arguments contained in the respondent's brief, and also in view of the further fact that no restriction exists against the payment of such compensation out of the new securities. Therefore, this Court should hold that Section 77(c)(12) should be interpreted as urged by respondent.

If, however, this Court should not so hold, it should hold that reasonable compensation may be allowed by the courts below out of the new securities. We should regret the adoption of this alternative because we think that in practice it would be less desirable for bondholders than to have payment made out of the mortgaged property.

CONCLUSION

The judgment of the Circuit Court of Appeals should be affirmed.

Dated, December 26, 1942.

Respectfully submitted,

H. C. McCOLLUM,,

One Wall Street,

New York, N. Y.,

Attorney for Irving Trust Company,

Amicus Curiae.

